

**Office of Chief Counsel
Internal Revenue Service
memorandum**

Number: **201117026**

Release Date: 4/29/2011

CC:TEGE:EOEG:ET2:
POSTU-149342-09

UILC: 117.06-09, 3121.01-00

date: January 06, 2011

to: Renee Wells, Area Manager
(Tax Exempt & Government Entities)

from: Marie Cashman, Special Counsel, Employment Tax, Division Counsel/Associate
Chief Counsel
(Tax Exempt & Government Entities)

subject:

This memorandum responds to your request for comments on the Protest submitted by Taxpayer relating to the proposed disallowance of refund claims filed with respect to payments made to certain non-NRSA fellows.

LEGEND

Taxpayer =

Issue

Whether amounts paid to certain non-NRSA fellows under non-NRSA research grants are wages subject to Federal Insurance Contributions Act (FICA) taxes.

Background

A Chief Counsel Advice issued on July 29, 2009, relating to this case included a lengthy discussion of the factual similarities and differences between NRSA training grants and non-NRSA research grants and a discussion of the applicable law under § 117(c) and § 3121(a). The CCA concludes that payments to NRSA fellows under NRSA training grants are not subject to FICA but that payments to non-NRSA fellows under non-NRSA research grants constitute a payment for services and are wages for FICA tax purposes.

After considering both the factual representations and legal arguments set forth in the Protest, CC:TEGE reaffirms the conclusion set forth in the CCA.

Protest: General Comments

Taxpayer contends that payments to certain non-NRSA fellows are excludible from wages for FICA tax purposes. In support of its contention Taxpayer represents that the primary purpose of its research training program is to train and educate individuals in scientific research and that the primary purpose of its payments to certain non-NRSA fellows is to defray their cost of living while they prepare for a career in scientific research.¹ Additionally, Taxpayer maintains that it administers its sponsored research program consistent with standards established for NRSA fellows by the NIH and that Taxpayer does not differentiate between fellows receiving NRSA training grants and fellows receiving non-NRSA research grants.² Thus, Taxpayer concludes that certain non-NRSA fellows “are not employees receiving wages but instead are trainees receiving stipends to offset their living expenses.”³

Whether payments made to non-NRSA fellows are compensation for services and wages for FICA tax purposes depends on the facts and circumstances of the particular payment. In turn, the relevant facts and circumstances generally reflect and comport with the legally binding terms and conditions of a particular sponsored research award (usually documented by a contract, memorandum of understanding, or other formal mechanism). The terms and conditions of a sponsored research award determine the permissible costs incurred and payments made with respect to the award—including payments to non-NRSA fellows performing sponsored research. Thus, the critical consideration is not the primary purpose of Taxpayer’s research training program, but, rather, the terms and conditions of the relevant sponsored research award and the facts and circumstances relating to the disbursement of funds in accordance therewith.

As discussed below NRSA training grants constitute less than % of Taxpayer’s sponsored research awards whereas non-NRSA research grants constitute approximately %. Payments made under NRSA training grants are cost-of-living stipends used to support research training and are not considered salaries; conversely, payments made under non-NRSA research grants are compensation for personal services that the NIH considers to be salaries and wages. The terms and conditions applicable to the overwhelming majority of Taxpayer’s non-NRSA research grants expressly prohibit the payment of stipends, scholarships, or fellowships with research grant funds and require all payments for personal services performed with respect to sponsored research to be treated as compensation and wages. Effectively, Taxpayer maintains that it complies with the terms and conditions of the non-NRSA research grants in form by treating payments to non-NRSA fellows as compensation for personal

¹ Protest Letter from

[hereinafter Protest] (on file with IRS).

² *Id.* at 3, 6, 10, 25, and 35.

³ *Id.* at 25.

services, but that in substance (and for tax purposes) such payments are actually stipends rather than compensation for services. However, a review of Taxpayer's accounting policies and procedures as implemented by Taxpayer's

indicates that Taxpayer has organized and operated its sponsored research program to comply in both form and substance with the % of its sponsored research awards that are non-NRSA research grants. Similarly, a review of documents relating to the implementation of the non-NRSA research grants clearly demonstrates facts and circumstances that are consistent with the payment of compensation for personal services.

Consistent with the terms and conditions of the non-NRSA research grants and with Taxpayer's administrative policies and procedures, Taxpayer acknowledges that two-thirds of its non-NRSA fellows are employees receiving compensation for personal services and wages for FICA tax purposes.⁴ Nonetheless, Taxpayer maintains that payments made to the remaining one-third of its non-NRSA research fellows are indistinguishable from cost-of-living allowances paid to NRSA training fellows and, therefore, that such payments are not compensation for personal services. If true, the majority of such payments would violate Taxpayer's contractual obligations under the sponsoring non-NRSA research grants. Taxpayer's attempt to distinguish one-third of the non-NRSA fellows from the remaining two-thirds whom Taxpayer acknowledges to be employees receiving wages flatly contradicts the terms and conditions of the sponsoring research grants. Programmatically and contractually, the distinction is between NRSA fellows and all non-NRSA fellows, not between one-third of the non-NRSA fellows and the remaining two-thirds. Notwithstanding Taxpayer's representations to the contrary, both the form and the substance of Taxpayer's employment relationship with its non-NRSA fellows are consistent with the terms and conditions of the various sponsored research awards and with the policies and procedures established by Taxpayer's

Throughout the Protest Taxpayer describes in significant detail the administrative offices it has established to administer its sponsored research awards and provides citations to numerous documents specifically addressing the operation of Taxpayer's sponsored research programs. In considering the Protest we reviewed many of the documents and online resources identified by Taxpayer. Pursuant to Taxpayer's

and Taxpayer's

the vast majority of Taxpayer's sponsored research grants are administered by Taxpayer's and are subject to the cost accounting principles of Office of Management & Budget Circular A-21, *Cost Principles for Educational Institutions*. As explained herein, OMB Circular A-21 requires Taxpayer to provide documentation and certifications with respect to compensation for personal services paid to non-NRSA fellows that are fundamentally inconsistent with the factual representations Taxpayer makes in the Protest. Taxpayer's payment of compensation

⁴ *Id.* at 5, 18.

for personal services in accordance with OMB Circular A-21 constitutes wages for FICA tax purposes with respect to all of Taxpayer's non-NRSA fellows-not just with respect to the two-thirds acknowledged by Taxpayer.

As explained in the CCA and considered further herein, critical differences exist between NRSA training grants and non-NRSA research grants, and Taxpayer's research programs are not the same as or even substantially similar to the NRSA training program. Based on the documents reviewed Taxpayer's non-NRSA fellows receive compensation for personal services in accordance with the terms and conditions of the applicable sponsored research award. Taxpayer's assertion that it does not distinguish between NRSA fellows and non-NRSA fellows is simply untrue. Taxpayer operates its grant program in a manner that distinguishes between NRSA training grants and non-NRSA research grants, and Taxpayer's

and require it to comply with OMB Circular A-21, which mandates different treatment. Taxpayer's assertions regarding the factual similarities of NRSA training grants and certain non-NRSA research grants blur important differences between two fundamentally different programs and the Service should reject those assertions.

In the Service and Taxpayer agreed to conduct the examination of the refund claims at issue in accordance with a sampling agreement. Thus, Taxpayer provided various documents related to the grants in the sampling agreement, and the Service based its conclusion in the CCA on an application of the law to a subset of grants included in the sampling agreement. Taxpayer does not acknowledge the sampling agreement in the Protest, nor does it counter the analysis in the CCA with its own analysis of any specific non-NRSA grants included in the sample. In fact, Taxpayer does not directly object to the facts set forth in the CCA, except to note that some of the factual differences alleged in the CCA between NRSA and non-NRSA grants do not exist.⁵

This rebuttal references the following documents, copies of which have been provided for your convenience:

- OMB Circular A-21, *Cost Principles for Educational Institutions*.
- *NIH Grants Policy Statement*.

⁵ *Id.* at 5.

Following is a more detailed discussion of Taxpayer's Protest.

I. Scholarships and Fellowship Grants can be wages subject to FICA.

Taxpayer asserts that the Service's long-standing position has been that scholarships and fellowship grants are not wages and, therefore, are not subject to FICA taxation.⁶ Taxpayer's assertion is incorrect. As the CCA indicates, since the enactment of § 117(c) in the mid-1980s, the Service's position has consistently been that amounts—no matter what their label—that meet the criteria of payments for services under § 117(c) are wages subject to FICA (depending, like all other applications of FICA, on the nature of the employment and the status of the organization).⁷ Furthermore, the Service and applicable Treasury Regulations have long maintained that an amount is not excludable from gross income under § 117 if it (1) represents compensation for past, present, or future employment services, or (2) enables the recipient to pursue studies or research primarily for the benefit of the grantor.

In support of its position Taxpayer cites Revenue Ruling 71-378 for the proposition that amounts received pursuant to a scholarship or fellowship grant are not wages for FICA tax purposes. As a preliminary matter, however, Revenue Ruling 71-378 provides that “[w]hether an amount received by an individual is excludable from his gross income under § 117 of the Code depends upon the facts and circumstances under which the payment is made.” The revenue ruling then concludes that “[t]he facts in the instant case indicate that the primary purpose of the payments to the MEDEX trainees is to aid them in their education and training in their individual capacity and not to compensate them for services or primarily for the benefit of the grantor.” Thus, the holding in Revenue Ruling 71-378 is premised on the factual determination that the payments do not represent compensation for past, present, or future services. Furthermore, Revenue Ruling 71-378 was promulgated prior to the enactment of § 117(c) which explicitly provides that the § 117 exclusion does not apply “to that portion of any amount received which represents payment for teaching, research, or other services.”⁸ Consequently, pursuant to both Revenue Ruling 71-378 and § 117(c), the Service has consistently maintained that a payment for services—regardless of its label—is not excludable from gross income or wages under § 117.

Similarly, Taxpayer cites Revenue Ruling 60-378 for the proposition that scholarships and fellowship grants do not constitute income from a trade or business and that the terms “fellowship grant” and “trade or business” are mutually exclusive. As

⁶ *Id.* at 19.

⁷ Notice 87-31, 1987-1 C.B. 475.

⁸ See *id.* (stating that “section 117(c), as amended by the Act, provides that gross income includes any portion of amounts received as a scholarship or fellowship grant representing payment for teaching, research or other services required as a condition for receiving the qualified scholarship”).

with Revenue Ruling 71-378, however, the amount received must constitute “a fellowship grant which qualifies as such under § 117 of the Code,” i.e., the amount must not represent compensation for past, present, or future services. Thus, Revenue Ruling 60-378 stands for the proposition that noncompensatory scholarship and fellowship grants do not constitute income from a trade or business, whether or not such amounts are required to be included in gross income.

While acknowledging that private letter rulings have no precedential value, Taxpayer nevertheless discusses private letter rulings 200607017, 200042047 (correct PLR number is 200042027) and 9851002 to support its contention that fellowship grants cannot be payments for services under § 117(c).⁹ In each of these rulings the Service concludes that stipends paid to individuals in connection with the taxpayers’ research training programs are “[m]odeled after the NRSA training programs and designed to mirror it” and are not compensatory within the meaning of 117(c). Therefore, the Service concludes that such amounts are excluded from income under § 117, are not wages for purposes of income tax withholding under section 3401(a), and are not wages for FICA purposes. However, these rulings do not stand for the proposition that any payment labeled a “fellowship” cannot be a wage for FICA purposes; rather, each ruling clearly indicates that any amount with any designation is a payment for services under § 117(c) if it is compensatory in nature. Further, each ruling is explicit—the determination of whether an awards program or a research training program makes compensatory payments within the meaning of § 117(c) of the Code is an inherently factual matter requiring consideration of the nature and extent of the impositions and duties imposed upon the participants and all other relevant facts and circumstances of the program. Lastly, each ruling emphasizes that the conclusion therein was reached based on the information presented and the representations furnished by the taxpayer and assumes the programs were conducted substantially as described. Thus, the facts and circumstances of each case must be examined. As discussed below, the facts in this case clearly demonstrate that salaries paid to fellows under non-NRSA research grants are for services performed with respect to various sponsored research projects.

II. Stipends paid under NRSA training grants differ fundamentally from salaries and wages paid under non-NRSA research grants.

During the years at issue the federal government funded the majority of Taxpayer’s sponsored research awards (from a low of % in to a high of % in).¹⁰ Accordingly, federal grants funded the majority of salaries and wages paid to non-NRSA fellows and NIH grants funded 100% of stipends paid to NRSA fellows. In the Protest Taxpayer acknowledges the dominant role of federal grants in funding its sponsored research program:

- “The attracted over \$ million dollars in research awards in fiscal

⁹ Pursuant to § 6110(k)(3) a written determination may not be used or cited as precedent.

¹⁰ See

year and \$ million dollars in fiscal year . Of this total, approximately percent in and percent in originated from federal grants, primarily the National Institutes of Health (\$ million in and \$ million in) and the National Science Foundation (\$ million in).”¹¹

- “Thus, the majority of the research funding comes from the U.S. and state governments, with the bulk coming from the NIH. The NIH funding is via several programs, including the Ruth L. Kirschstein National Research Service Award training award program and the NIH Research Project Grant Program (RO1s).”¹²
- “The received over \$ of [sic] million of NRSA training grants in fiscal year . The following discussion focuses on the NIH’s NRSA training program as the taxpayer’s research training program does not differentiate between fellows, regardless of funding.”¹³ (Emphasis in original.)
- “As noted above, the receives approximately \$ million per year in NRSA training grants.”¹⁴

As indicated, Taxpayer acknowledges that “the receives approximately \$ million per year in NRSA training grants.” Consequently, Taxpayer’s representation that “[t]he received over \$ of [sic] million of NRSA training grants in fiscal year ” is grossly inaccurate. In actuality, for fiscal year Taxpayer received a total of \$ in sponsored research awards of all kinds from the National Institute of Health and a total of \$ in sponsored research awards from the federal government.¹⁵ Thus, NRSA training grants constituted approximately % of sponsored research awards granted to Taxpayer by NIH in fiscal year —not the % claimed by Taxpayer—and approximately % of sponsored research awards granted to Taxpayer by the federal government.

Similarly, for fiscal year the federal government funded % of Taxpayer’s sponsored research awards (\$ out of a total of \$).¹⁶ Of the federal funds awarded, however, only \$ (%) constituted NRSA training grants.¹⁷ Thus, less than % of federal funds awarded to Taxpayer in fiscal year for sponsored research programs constituted NRSA training grants. Conversely, over % of sponsored research awards funded by the federal government were for

¹¹ Protest at 6.

¹² *Id.*

¹³ *Id.*

¹⁴ *Id.* at 8.

¹⁵

¹⁶ , at 11.

¹⁷

¹⁷ , at 7.

¹⁷

non-NRSA awards. By Taxpayer's own admission, for the years at issue NRSA training grants constituted approximately % (\$ million per year) of the sponsored research awards funded through federal grants.

In describing its sponsored research program Taxpayer "focuses on the NIH's NRSA training program as the taxpayer's research training program does not differentiate between fellows, regardless of funding."¹⁸ (Emphasis in original.) Thus, Taxpayer represents that NRSA training grants which constitute less than % of Taxpayer's sponsored research awards are illustrative of the manner in which Taxpayer conducts the remaining % of its sponsored research program. This is not in fact the case. The terms and conditions established by NIH with respect to stipends paid under NRSA training grants are fundamentally different from the terms and conditions applicable to compensation for personal services paid under other sponsored research awards funded by the federal government, i.e., the majority of non-NRSA grants.

Cost principles imposed by the federal government and incorporated into the prohibit the payment of stipends (as defined by NIH) from non-NRSA research awards and mandate the treatment as salaries and wages of compensation for personal services paid to non-NRSA fellows. Thus, programmatically and procedurally, NRSA training grants differ from all other research awards funded by the federal government. As discussed below Taxpayer's historical treatment of amounts paid to non-NRSA fellows as wages for FICA tax purposes is in accord with the terms and conditions of the Office of Management and Budget's *Cost Principles for Educational Institutions*¹⁹, the *NIH Grants Policy Statement*, and the

. In both form and substance non-NRSA fellows funded through % of Taxpayer's sponsored research awards are employees receiving compensation for personal services and wages for FICA tax purposes.

A. Ruth L. Kirschstein National Research Service Awards

The purpose of the NRSA program is to ensure that a diverse and highly trained workforce is available in adequate numbers and in the appropriate research areas and fields to carry out the nation's biomedical and behavioral research agenda.²⁰ NIH awards NRSA institutional research training grants to eligible institutions to develop or enhance research training opportunities for individuals, selected by the institution, who are training for careers in specified areas of biomedical, behavioral, and clinical research. Similarly, NIH awards individual predoctoral and postdoctoral fellowships to promising applicants with the potential to become productive, independent investigators in fields related to the mission of NIH.

¹⁸ Protest at 6.

¹⁹ See OMB Circular A-21, 2 CFR Part 220, Appendix A.

²⁰ Part II, Subpart B of the *NIH Grants Policy Statement* contains information about and application requirements for NRSA institutional research training grants and NRSA individual fellowships.

Under the terms of the NRSA program, the sponsoring institution pays the fellows a stipend to defray living expenses during the research training experience. Stipend is a defined term in the *NIH Grants Policy Statement*:

Stipends: Allowable as cost-of-living allowances for trainees and fellows only under Kirschstein-NRSA individual fellowships and institutional research training grants. These payments are made according to a preestablished schedule based on the individual's experience and level of training. A stipend is not a fee-for-service payment and is not subject to the cost accounting requirements of the cost principles. . . . Stipends are not allowable under [non-NRSA] research grants even when they appear to benefit the research project. *NIH Grants Policy Statement*, at 99.

The stipend is funded by the NRSA grant and the sponsoring institution disburses the stipend in accordance with levels established by NIH. Payment of the stipend is not dependent on the fellow having an employment relationship with either the federal government or the sponsoring institution and is not considered compensation for the services expected of an employee. Consequently, the sponsoring institution may not seek funds or charge individual fellowship awards for costs normally associated with employee benefits (for example, FICA, workman's compensation, and unemployment insurance). Stipends and trainee costs are allowable only under predoctoral and postdoctoral NRSA training grants.

NRSA fellows may seek paid part-time employment with the sponsoring institution to offset additional expenses. If the NRSA fellow undertakes employment incidental to the training program, any compensation received will not be a stipend because it will not have been paid from the NRSA grant. Sponsoring institutions may pay funds characterized as compensation only when there is an employer-employee relationship with the fellow, the payments are for services rendered, and the situation otherwise meets the conditions for compensation of students as detailed in the *NIH Grants Policy Statement*. Furthermore, the sponsoring institution may not pay compensation from a research grant that supports the same research that is part of the fellow's planned training experience as approved in the NRSA individual fellowship application. Fellowship sponsors must approve all instances of employment on unrelated research grants to verify that the circumstances will not detract from or prolong the approved training program.

NIH policies explicitly require Taxpayer to treat its NRSA fellows differently than its non-NRSA fellows. Accordingly, the *NIH Grants Policy Statement* describes the terms, conditions, and requirements for NRSA and non-NRSA grants in separate sections. Distinctions between the grant programs as explained in the applicable sections are consistent with those detailed in the July 2009 CCA.

B. NIH Research Grant Programs (non-NRSA Research Grants)

As discussed above more than % of the funding received by Taxpayer from the federal government during the years at issue was for non-NRSA research awards.²¹ Approximately % of the federal government's funding came from NIH. For purposes of characterizing sponsored research awards the *NIH Grants Policy Statement* defines the term "research" as follows:

Research: A systematic, intensive study intended to increase knowledge or understanding of the subject studied, a systematic study specifically directed toward applying new knowledge to meet a recognized need, or a systematic application of knowledge to the production of useful materials, devices, and systems or methods, including design, development, and improvement of prototypes and new processes to meet specific requirements. Also termed "research and development." *NIH Grants Policy Statement*, at 14.

The most significant of NIH sponsored research awards received by Taxpayer during the years at issue are described below:

NIH Research Project Grants (R01): These awards are made to support a discrete, specified, circumscribed project to be performed by the named investigator(s) in an area representing the investigator's specific interest and competencies, based on the mission of NIH. Research Project Grants can be investigator-initiated or in response to a program announcement. While the investigator-initiated research plan does not need to meet a specific program's requirements, it must be related to the program interest of the research institute. Funds from the grants may be used for salary and fringe benefits for the principal investigator, key personnel, and other essential personnel.

NIH Exploratory/Developmental Research Grants & Resource-Related Research Projects (R21 & R24): Exploratory/Developmental Research Grants encourage exploratory and developmental research by providing support for the early and conceptual stages of project development and are generally distinct from projects supported through the traditional R01 grants. Resource-Related Research Projects provide resources to enhance research infrastructure and to facilitate the investigation of issues requiring multiple expertise to focus on a single complex problem. Research projects must address a national need that fulfills NIH's strategic vision while providing resources to the broader scientific community.

Research Education Grants (R25): Research Education Grants are used to promote an appreciation for and interest in biomedical research, to provide additional training in specific areas, and/or to develop ways to disseminate scientific discovery into public health and community applications. These grants support creative and innovative educational programs designed to facilitate the development of investigators in

²¹ Part II, Subpart A of the *NIH Grants Policy Statement* contains an overview of the terms and conditions applicable to non-NRSA research grants.

appropriate scientific areas. All personnel costs (including administrative and clerical costs, as well as salaries of the project director, principal investigator, and other participants) associated with directing, coordinating, administering, and implementing the program must be justified and reasonable.

The terms and conditions of each of these research grants prohibit the sponsoring institution from using funds to pay stipends, scholarships, or fellowships even when such payments would appear to benefit the research project.²² By their terms these grants—unlike NRSA training grants—prohibit Taxpayer from using the funds for anything but particular research services. Therefore, when awarded these grants, Taxpayer had to limit the non-NRSA fellows' research activities to performing those services necessary for Taxpayer to fulfill its commitment under the grant. NRSA fellows' training activities are not subject to similar limitations.

C. Administration of Taxpayer's Sponsored Research Program

Taxpayer's _____ is responsible for coordinating programs and activities that lead to awards for specific purposes. These awards are often referred to as sponsored programs and are documented by a contract, cooperative agreement, memorandum of understanding, or other formal mechanism between Taxpayer and the grantor.²³ Taxpayer treats both NRSA training grants and non-NRSA research grants as sponsored research awards.²⁴ Sponsors provide funding to Taxpayer with the understanding that the sponsor will receive value from Taxpayer commensurate with the magnitude of the award and that the sponsor may withdraw the award if that value is not received.

²² See *Kao v. Commissioner*, T.C. Memo 1977-288 (T.C. 1977), concerning the payment of a research associate's salary under a research grant awarded by the National Institutes of Health. The court describes the terms of the research grant as follows:

NIH approves salaries of project personnel only if the person renders personal services to the project. Although NIH awards training and fellowship grants to recipients who do not render personal services, no such provisions exist on research grants.

Similarly, see *Woodfin v. Commissioner*, T.C. Memo. 1972-49 (T.C. 1972), concerning the payment of a research associate's salary under a basic research grant awarded by the National Science Foundation. The court describes the terms of a basic research grant as follows:

Under a basic research grant, funds are made available for the hiring of a research associate because such person will be needed to assist in performing the research called for under the grant. The NSF does not make funds available for hiring a research associate for the purpose of enabling an individual to further his training or education in his individual capacity.

²³ See

²⁴ In this regard Taxpayer's practices conform with the definition of the term "sponsored research" as set forth in OMB Circular A-21. See 2 C.F.R. Part 220, Appendix A, § B.1.b.(1) (2010).

Taxpayer established the _____ to execute the fiscal and contractual responsibilities vested in the _____ and to monitor compliance with the terms and conditions of _____ sponsored research awards. Taxpayer is accountable for the appropriate use of funds awarded under authorized programs and for the performance of the project or activities resulting from the award. To facilitate compliance with Taxpayer's contractual obligations, the _____ prepared _____ as a primer for research administrators on major topics included in the federal regulations. _____ emphasizes that accepting federal awards subjects Taxpayer to certain obligations and responsibilities outlined in Office of Management and Budget circulars and in the _____. _____ further emphasizes that the financial administration of sponsored awards is a shared responsibility requiring collaboration among the principal investigator, academic unit, campus, and Taxpayer. There can be no doubt that Taxpayer established these administrative offices and accompanying internal procedures to ensure compliance with the terms and conditions of all sponsored research awards. Compliance is critical—Taxpayer receives approximately \$ _____ million in sponsored research awards annually and wants to increase that amount.

Meeting the requirements set forth in the *Cost Principles for Educational Institutions* (OMB Circular A-21) is an important component of Taxpayer's compliance obligations. OMB Circular A-21 provides principles for determining the costs applicable to research and development, training, and other sponsored work performed by colleges and universities under grants, contracts, and other agreements with the federal government. All federal agencies that sponsor research and development, training, and other work at educational institutions must apply the provisions of OMB Circular A-21 in determining the costs incurred for such work.²⁵ Consequently, _____ and the _____ require Taxpayer to use OMB Circular A-21 for purposes of identifying costs Taxpayer can charge to federal awards, i.e., costs directly related to the performance of a sponsored award and permitted under its terms and OMB circulars.²⁶ Notably, the *NIH Grants Policy Statement* provides that "[t]he cost principles [of OMB Circular A-21] apply to all NIH award instruments, award mechanisms, and special programs and authorities . . . with one exception: they do not apply to Kirschstein-NRSA individual fellowship awards." (Emphasis added.)²⁷ However, OMB Circular A-21 does apply to _____

²⁵ See 2 C.F.R. Part 220, § 220.20(a) (2010).

²⁶ See _____

²⁷ Similarly, OMB Circular A-21 provides that "[t]he principles do not apply to arrangements under which federal financing is in the form of loans, scholarships, fellowships, traineeships, or other fixed amounts based on such items as education allowance or published tuition rates and fees of an institution." See 2 C.F.R. Part 220, Appendix A, § A.3.a (2010).

all compensation for personal services paid to employees for services rendered under sponsored agreements.²⁸

In accordance with OMB Circular A-21 Taxpayer requires employees working on activities related to non-NRSA federal awards to complete These reports list the employee's base pay, payroll funding sources, plan for payroll distribution at the beginning of the reporting period, and actual payroll distributions during the reporting period. Taxpayer uses the "Plan-Confirmation" method for effort reporting, as described in OMB Circular A-21, pursuant to which Taxpayer bases the distribution of salaries and wages of professorial and professional staff on budgeted, planned, or assigned work activity. Taxpayer's accounting procedures require employees identified on the to allocate their time based on the total activity within his or her appointment, including all research, teaching, clinical service, and administrative duties. If the employee is not available to complete the report, another person with direct knowledge of 100% of the individual's effort must sign the report and must confirm that the report represents a reasonable estimate of the work performed by the listed employee for the documented period.²⁹ At the end of the award the principal investigator must certify that all expenditures reported in the general ledger for an award are allowable in accordance with provisions of the award documents. The principal investigator then files the signed certificate with the

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As discussed above stipends paid under NRSA institutional research training awards and NRSA individual fellowships are cost-of-living allowances provided on a preestablished schedule. Hence, such stipends are neither compensation for the performance of services by an employee nor subject to the cost accounting requirements set forth in OMB Circular A-21. Appropriately, Taxpayer did not treat stipends paid under NRSA training grants as wages for FICA tax purposes. Conversely, compensation for personal services paid under non-NRSA research grants is salary and wages for services rendered to the grant supported project. In accordance with OMB Circular A-21, the *NIH Grants Policy Statement*, and Taxpayer's , payments to post-doctoral fellows under non-NRSA research grants are fee-for-service payments with respect to specific research grants. Compensation for personal services includes all amounts paid for employee services rendered to a grant-supported project and is subject to the applicable cost accounting requirements of OMB Circular A-21 (including the completion of

²⁸ See 2 C.F.R. Part 220, Appendix A, § J.10.a (2010).

²⁹ See

; see also the *NIH Grants Policy Statement*, at 97 which provides as follows with respect to educational institutions using the plan-confirmation method: "At least annually, the employee, PI [Principal Investigator], or responsible officials will verify, by suitable means, that the work was performed and that the salaries and wages charged to sponsored agreements, whether as direct charges or in other categories of cost, are reasonable in relation to the work performed."

³⁰ See

).³¹ Consequently, Taxpayer has historically and correctly treated compensation for personal services as wages for FICA tax purposes.

Taxpayer now asserts that, contrary to the express requirements of OMB Circular A-21, the *NIH Grants Policy Statement*, and Taxpayer's own , Taxpayer's payments to non-NRSA fellows were stipends (cost-of-living allowances) rather than compensation for personal services. Taxpayer makes this argument notwithstanding the explicit prohibition in the *NIH Grants Policy Statement* against the payment of stipends, scholarships, or fellowships from NIH research grant funds and notwithstanding Taxpayer's representations in certified by principal investigators regarding the non-NRSA fellows' performance of personal services on behalf of grant supported projects. A payment that constitutes compensation for personal services under OMB Circular A-21 also constitutes a payment for services under § 117(c) and, consequently, wages for FICA tax purposes. Taxpayer purports to have complied in form—but not in substance—with the terms and conditions of the applicable non-NRSA research grants. In fact, through the payment of compensation for personal services and of wages for FICA tax purposes, Taxpayer has complied with both the form and the substance of the applicable non-NRSA research grants.

III. Taxpayer's training program distinguishes between NRSA and non-NRSA fellows.

Taxpayer repeatedly asserts that its "research training program does not differentiate between fellows, regardless of funding," and that "the expectations of full-time research, publication, and collaborative learning of the [Taxpayer's] NRSA fellows is virtually the same as that of [non-NRSA] fellows training with any other type of research funding."³²

Taxpayer's support for such sweeping statements is apparently based in part upon statements proffered by five of its professors.³³ Any such subjective statements are anecdotal at best. Further, while they may indeed reflect these professors' genuine observations, such observations do not address the ultimate issue in this case and they are not relevant. What is relevant are the conditions Taxpayer requires payment recipients to fulfill. As discussed in the CCA, and in more depth below, the conditions that non-NRSA fellows must fulfill to receive their payments are substantively, and substantially, different from those that NRSA fellows must fulfill.³⁴

³¹ See OMB Circular A-21, 2 C.F.R. Part 220, Appendix A, § J.10 (2010) for a definition of the term "compensation for personal services" and a description of the principles to be applied in determining allowable costs with respect thereto.

³² See, e.g., Protest at 5, 6, 10, 25, 26, 29, 32, 33, and 35.

³³ Protest at 6 n.16 & 17.

³⁴ See, e.g., I.R.S. Chief Counsel Advice Mem. 200944027, at 5-9, 15-17 (July 22, 2009) [hereinafter CCA] (on file with IRS) (summarizing, and analyzing, facts that distinguish the NRSA program from the non-NRSA program).

These statements are also at odds with how Taxpayer has treated its payments to post-doctoral fellows in the present matter. That is, here Taxpayer is treating payments to NRSA fellows as not subject to FICA taxes, while treating payments to two-thirds of the individuals who are classified as non-NRSA fellows as wages subject to FICA taxes. This distinction is at odds with Taxpayer's contention that "the activities of all research fellows at the [Taxpayer's institution] are the same as the research activities of the NRSA fellows at the [Taxpayer's institution]"; were this so, Taxpayer's payroll system presumably would classify payments to all fellows—whether NRSA or non-NRSA—in the same way.³⁵

Similarly, Taxpayer's employment policies make objective distinctions between NRSA and non-NRSA fellows. Namely, these employment policies distinguish those fellows whom it refers to as "employee fellows" from "non-employee fellows" (sometimes referred to as "educational fellows"). Taxpayer classifies non-NRSA fellows as the former, and NRSA fellows as the latter. A significant consequence of this distinction is that Taxpayer offers different fringe benefit packages to these two general sets of fellows,³⁶ providing those fellows who are employee fellows with an extensive array of fringe benefits, including tax-deferred investments, flexible spending accounts, military leave, and retirement benefits,³⁷ while limiting non-employee fellows' fringe benefits to a different—and more limited—universe of fringe benefits, including medical insurance subsidies and certain fee waivers.³⁸ Taxpayer's written communications with these two categories of fellows also demonstrate its contrasting treatments of the groups. For example, Taxpayer provides the two categories of fellows with substantively different offer and reappointment letters.³⁹

IV. Factual Disagreements

As discussed in the CCA, whether an amount is a payment for services under § 117(c) is a function of the applicable facts and circumstances. In its Protest, Taxpayer references several facts and circumstances in support of its assertions that:

- the primary purpose of all of its research training programs is "to train and educate individuals in scientific research to ensure that highly trained scientists are available in adequate numbers and in the appropriate disciplines to

³⁵ Taxpayer's statements are also fundamentally at odds with the documentation and certifications that Taxpayer is required to provide under OMB Circular A-21 with respect to most payments it makes to non-NRSA fellows

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/i. If coverage under a qualified retirement plan or other employee benefit plan was provided, the outcome of this matter could affect the tax treatment of such a plan or benefits under such a plan.

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implement the nation's research agenda,"⁴⁰

- the primary purpose of the payments that non-NRSA fellows receive is to "enable the research fellow to pursue a course of study preparatory to a career in scientific research,"⁴¹
- "the non NRSA research fellows participating in the research training programs should be exempt from FICA taxation as all the training programs at the are substantially the same as the NRSA training programs and no research fellows at the receive any quid pro quo for the research services performed,"⁴² and
- "[t]he research training stipends at the do not possess the indicia of compensation."⁴³

Yet there is simply no reason to conclude that the facts and circumstances that Taxpayer advances in support of these arguments accurately reflect the facts and circumstances of this matter. Taxpayer supports its key factual contentions with scant, and often no, direct evidence. By contrast, in both the CCA and below, the Service uses direct evidence to support its position. The Service has collected much of this evidence from hundreds of documents (hereinafter referred to in this Rebuttal as "the documents"). The documents, which include applications for grants, progress reports, offer letters, and other correspondences, are direct evidence of the facts and circumstances of this case, and consistently and unambiguously demonstrate both that Taxpayer's presentation of the facts and circumstances of the present matter are incorrect, and that amounts Taxpayer provided to non-NRSA fellows are payments for services under § 117(c).⁴⁴ In particular:

Fellow Selection: Taxpayer states that the same selection and recruitment process "typically" applied for all fellows regardless of the source of funding and acknowledges that each laboratory selects its own fellows.⁴⁵ Taxpayer also states "generally, once

⁴⁰ Protest at 3.

⁴¹ *Id.*

⁴² *Id.* at 33.

⁴³ *Id.* at 35.

⁴⁴ It is also worth noting here that the Taxpayer's own characterization of the payments would amount to an unauthorized use of funds under *Vaccaro v. Commissioner*, 58 T.C. 721, 729 (1972). That is, in *Vaccaro*, the court stated that the fact that the University was required to make the form of the payments compensatory, while it in fact made the substance of the payments non-compensatory, may have amounted to "using earmarked funds for non-authorized purposes." As in *Vaccaro*, Taxpayer in the present matter is required to make the form of payments compensatory. See *supra* Part II. Therefore, *Vaccaro* indicates that were the facts in the present case as Taxpayer contends—that is, if it was the case that the substance of the fellows' payments were not compensatory, while the form of those payments was compensatory—Taxpayer would, in effect, be using the non-NRSA funds for unauthorized purposes.

⁴⁵ Protest at 11-12.

fellows have been accepted into the particular training program, a decision is made by the department or program to support a fellow with specific funding.”⁴⁶ Taxpayer’s description of its training programs and selection of fellows suggests that a fellow is first appointed to a training program and then must seek out a mentor and funding. Yet the direct evidence, as illustrated in the documents, consistently and objectively suggests that the reality is otherwise. In fact, Taxpayer hires non-NRSA fellows to provide specific substantive services on specific projects to enable it to fulfill its contractual obligations to the granting agency. Numerous appointment letters illustrate this point by advising the payment recipient of the specific duties expected to be performed, the focus of the research expected, or describing how the researcher was to spend 100% of her time. For example, Taxpayer enumerated one non-NRSA fellows’ duties as

.”⁴⁷ Taxpayer similarly defined another non-NRSA fellow’s specific duties when it stated in an appointment letter that his ”

.”⁴⁸ And it was in a similar fashion that Taxpayer told another non-NRSA fellow that his “

.”⁴⁹ Other documents indicated that this fellow devoted 100% of his time to this particular duty.⁵⁰ Contrary to the assertions that Taxpayer makes in its Protest, the documents thus indicate that Taxpayer in fact routinely engages non-NRSA fellows to provide particular research services for specific grants.

Publications: Taxpayer also asserts that publishing is merely a part of the educational process and that any articles authored by a non-NRSA fellow do not provide a significant benefit to the program, its principal investigator, or Taxpayer.⁵¹ Direct evidence indicates, however, that published articles, do, in fact, benefit Taxpayer. NIH Grant Progress Reports show that it is common for Taxpayer to cite such published articles co-authored by fellows as evidence of progress made towards fulfilling its contractual obligations under non-NRSA research grants.

⁴⁶ *Id.* at 12.

⁴⁷ Letter from

(on file with IRS).

⁴⁸ Letter from

(on file with IRS).

⁴⁹ Letter from

(on file with IRS).

⁵⁰ Memorandum from

(“One post-doc is required with 100% time commitment to this

project.”) (on file with IRS).

⁵¹ Protest at 14-15.

Taxpayer engaged the non-NRSA fellows for specific projects: Taxpayer asserts that “there are no specific tasks assigned to the [non-NRSA] fellows.”⁵² Yet the terms of non-NRSA research grants contractually required Taxpayer to assign such “specific tasks” to non-NRSA fellows to the extent that they contractually prohibited Taxpayer from using these funds for services that were not related to the substance of the grants. The documents thus routinely reflect a reality in which Taxpayer specified both the non-NRSA fellows’ particular tasks (as discussed above) and the order or sequence in which it expected the non-NRSA fellows to complete these tasks.⁵³

Non-NRSA fellows’ research activities remained constant: Many of the documents similarly counter Taxpayer’s assertion that “research fellows’ activities change weekly, depending upon the progress of each fellow’s training.” The documents instead demonstrate that non-NRSA fellows would pursue the same research projects over long periods of time. For example:

- Annual reports indicate that _____ performed the same research activities each year. Each report, in identical language, stated, “

.”⁵⁴
- Annual reports also indicate that _____’s research activities did not vary year to year. Each of these reports described _____’s research activities in identical language, stating, “

.”⁵⁵
- Progress reports indicated that Taxpayer intended for _____ to devote his time to “

.”⁵⁶ Later reports indicated that _____ devoted 100% of his time to this project.⁵⁷

⁵² *Id.* at 16.

⁵³ See, e.g., CCA at 18 (citing one appointment letter that explicitly stated that the non-NRSA fellow’s sponsor would determine the “specific nature” of her duties).

⁵⁴ Progress Report to the NSF (_____) (on file with IRS), Progress Report to the NSF, _____ (on file with IRS), Progress Report to the NSF, _____ (on file with IRS).

⁵⁵ Progress Report to the NSF, _____ (on file with IRS), Progress Report to the NSF, _____ (on file with IRS), Progress Report to the NSF, _____ (on file with IRS).

⁵⁶ Progress Report to the NIH, _____ (on file with IRS).

⁵⁷ *Id.* at 28

Here it is worth observing again that the terms of non-NRSA research grants prohibited Taxpayer from using the grants to compensate fellows for engaging in any activities other than the research services that the grants required. For example, one non-NRSA research grantor (the NSF) said explicitly that “[f]unds provided for participant support may not be diverted by the grantee to other categories of expense without the prior written approval of the cognizant NSF Program Officer.”⁵⁸ Taxpayer was thus contractually prohibited from providing fellows with non-NRSA funds if those fellows did not provide the specific research services that the non-NRSA funds were intended to produce.

Non-NRSA fellows do not have a large amount of freedom to determine their own research tasks: Disproving Taxpayer’s assertions that “[t]here are no specific tasks assigned to the fellows,” “each fellow has the discretion to determine when, where and how a research activity will be performed,” and “[f]ellows set their own schedule and spend as many hours per week in the lab as they choose” are numerous documents that show that non-NRSA fellows’ research activities are both managed and well-defined. The documents discussed above in part illustrate this point, demonstrating that Taxpayer hired the non-NRSA fellows to provide particular research services. Other documents are also relevant to this end when they indicate that Taxpayer heavily supervised the fellows. For example, when Taxpayer applied for the grant that it would ultimately use to compensate _____, it stated, “

”⁵⁹
.

Taxpayer benefits from non-NRSA fellows: Taxpayer states several times that it does not benefit from the non-NRSA fellows. It notes, for example, that “the consensus of the mentors . . . is that the fellows do not begin to provide values to the [Taxpayer] until after several years of training,”⁶⁰ the non-NRSA fellows “do not provide substantive research services to the [Taxpayer],” and that “[a]ny financial benefit provided to the [Taxpayer] by the fellow is merely incidental.”⁶¹ It further contends that “the activities of the research fellows during research training do not substantially benefit the laboratories at the [Taxpayer’s institution].”⁶² The direct evidence that the Service has reviewed reflects a far different reality, demonstrating that the non-NRSA research services are crucial to Taxpayer’s efforts to fulfill its contractual obligations to the agencies that provide it with research grants. In addition, Taxpayer’s notion that it receives minimal or no benefit from the non-NRSA fellows is simply irreconcilable with the fact that these

⁵⁸ Letter from

(on file with IRS).

⁵⁹ Application for DOE Grant (on file with IRS). See also CCA at 9 (presenting facts that illustrate that Taxpayer exercised authority “over how fellows spend their time,” influenced fellows’ choices of assistants, and “routinely specified the order or sequence along which non-NRSA fellows’ research was to proceed”).

⁶⁰ Protest at 13.

⁶¹ *Id.* at 3.

⁶² *Id.* at 33.

fellows perform substantial portions of the research services that are required by % of the over \$ million in research grants that Taxpayer receives each year that are non-NRSA grants. The argument that non-NRSA fellows do not provide significant financial benefits is thus not sustainable.

Many of the documents illustrate other concrete quantitative and qualitative ways in which the non-NRSA fellows provided benefits to Taxpayer, too. The documents demonstrate just how substantial the non-NRSA fellows' services were. These fellows often devoted more time to non-NRSA research projects than any other individuals who participated on the projects. For example, one progress report indicated that while a fellow devoted % of his research efforts to a particular grant, no other member of the research team devoted more than % of their research efforts to that grant. The non-NRSA fellows' qualitative contributions were no less beneficial to Taxpayer. The documents frequently indicate that Taxpayer viewed non-NRSA fellows as critical contributors to particular research projects. It was in this vein that Taxpayer, after describing the non-NRSA research project to which it would assign a certain fellow, stated that it needed him “

”⁶³

Also telling is the significant proportion of non-NRSA grant funds that Taxpayer used to pay non-NRSA fellow compensation. For example, Taxpayer used % of the annual funds of an grant to pay the salary and fringe benefits of a fellow. In the following year the amount increased to %.⁶⁴ Taxpayer derives substantial benefits from these research grants. Qualitatively, these grants illustrate “its dedication to advancement in scientific research.”⁶⁵ Quantitatively, these grants generate tens of millions of dollars each year. It simply does not stand to reason that Taxpayer would provide these funds to individuals from whom it did not expect to derive substantial benefits.

Non-NRSA fellows do sometimes perform the functions of research teaching assistants: Taxpayer contends that, “to suggest that fellows perform the function of a research teaching assistants [sic] is simply not true.”⁶⁶ This statement is overbroad and is specifically refuted by an appointment letter which states that a non-NRSA fellow's duties will include teaching. To this end, the appointment letter stated, “

”⁶⁷

The Payments that non-NRSA fellows receive do not merely defray cost of living: As discussed, different rules govern the amounts of payments to NRSA and non-NRSA

⁶³ Letter from

(on file with IRS).

⁶⁴ *Id.*

⁶⁵ Protest at 5.

⁶⁶ *Id.* at 3.

⁶⁷ Letter from

(on file with IRS).

fellows. The NIH, not Taxpayer, determines the amounts of the stipends provided to NRSA fellows. In contrast, it is Taxpayer (often, specifically, the principal investigator) that determines the amounts of the compensatory payments provided to non-NRSA fellows.⁶⁸ There is thus nothing that legally binds Taxpayer to limit non-NRSA fellows' payments to amounts sufficient only to defray their costs of living.

Furthermore, the Taxpayer's prepared in accordance with and the cost accounting principles mandated by OMB Circular A-21 require that the amounts of payments to certain non-NRSA fellows relate to activities for which the employee is compensated and be reasonable in relation to the work performed, whether or not such payments defray the fellows' living expenses. In other words, Taxpayer determines the amount of a payment it makes to a non-NRSA fellow by considering the amount of research services that the fellow provides, rather than by considering the fellow's cost of living.

The terms of Taxpayer's human resources policy manual clearly indicate that Taxpayer intends for these payments to non-NRSA fellows to function as more than mere offsets to recipients' costs of living. Specifically, the manual states:

“

”⁶⁹

Thus, the manual explicitly acknowledges that the amount of compensation fellows receive depends in large part on their qualifications (as opposed to their estimated costs of living).

And the documents themselves frequently illustrate that Taxpayer does not intend for payments to non-NRSA fellows merely to “to defray the cost of living.”⁷⁰ This direct evidence instead frequently demonstrates that Taxpayer sets the amount of non-NRSA fellows' compensation by, at least in part, determining the market-value of their research services. Taxpayer, for example, raised one non-NRSA fellow's compensation from \$ a year to \$ because this raise was necessary “

⁶⁸ Taxpayer acknowledges so much in the Protest at pp. 11-12, stating that RO1 awards provide funding for salary and fringe benefits of the principal investigator and may also include funding for such benefits for research fellows identified by the principal investigator. Taxpayer also confirms that the amount of stipend paid to a research fellow under an RO1 grant can be set by the principal investigator.

⁷⁰ Protest at 3.

.⁷¹ Similarly, among the factors that Taxpayer listed when it specified the factors it considered when it determined another non-NRSA fellow's \$ salary was, "⁷² Nor was cost of living relevant to any of the other factors that Taxpayer listed, which included "⁷³ To the same end, other direct evidence indicated that the increases to another non-NRSA fellow's salary would be based on "⁷⁴ , " rather than on variations in the cost of living.⁷⁴

The non-NRSA fellows do not need to experience several years of training before they provide value to Taxpayer: Taxpayer asserts that the fellows do not begin to provide value to Taxpayer until after several years of training and alleges that they do not provide substantive research services. This argument is inconsistent, however, with the fact that Taxpayer often provides its research services to the granting agency immediately after the grant commences, and it is non-NRSA fellows who typically provide the most substantial proportion of these research services. Various documents illustrate this point. In one application for a non-NRSA grant, for example, Taxpayer pledged that "

." Progress reports submitted by Taxpayer under non-NRSA research grants similarly illustrate fellows making immediate contributions.

The Payments Bear Substantial Indicia of Compensation: Taxpayer also argues that "[t]he research training payments at do not possess the indicia of compensation."⁷⁵ Yet the CCA and preceding discussion demonstrate that these payments did, in fact, frequently possess indicia of compensation, in that recipients quickly provided Taxpayer with valuable and enumerated services, Taxpayer determined the payments amounts, in part, by reference to the market value of the non-NRSA fellows' services, and Taxpayer based its selection of these non-NRSA fellows on their aptitudes to provide research services.⁷⁶

Circular A-21/Accounting Principles: As discussed earlier, another fact and circumstance that more generally refutes Taxpayer's argument that amounts received by non-NRSA fellows are not payments for services is that Taxpayer has in fact treated these payments as compensation for personal services.⁷⁷ Namely, Taxpayer is

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(on file with IRS) (

⁷²).

(on file with IRS) (

⁷³).

⁷⁴ *Id.*

⁷⁴ Letter from

(on file with IRS).

⁷⁵ Protest at 35.

⁷⁶ See, e.g., CCA at 15-17.

⁷⁷ See *supra* Section II.

contractually obliged to treat compensation for personal services paid under non-NRSA research grants as salary and wages for services rendered. The *NIH Grants Policy Statement*, and Taxpayer's _____, specify that payments to fellows under non-NRSA research grants are fee-for-service payments with respect to specific research grants.

V. The cases that Taxpayer cites are distinct from the facts of the present matter in several crucial ways.

Taxpayer cites several cases that it contends support its argument that the payments it made to non-NRSA fellows are not payments for services. It argues, in particular, that the facts in these cases “closely resemble the facts at the _____. In each case, the court held that the payments were fellowship grants rather than disguised compensation. The courts based their decisions upon their analyses of the facts of the cases in light of Treasury Regulations §§ 1.117-4(c)(1) and (2).”⁷⁸ The Service does not dispute that these cases hold that individuals’ payments were not payments for services. The Service does, however, dispute the notion that these cases in fact support Taxpayer’s argument. That is, the very facts and circumstances upon which these cases rested their conclusions, that the amounts at issue were not payments for services, are distinguishable from the facts and circumstances of the present case in several crucial ways. The following discussion summarizes these distinctions, which are discussed in more detail in both the CCA and the above discussion. In particular:

A. *Krupin v. United States*, 439 F. Supp. 440 (D.E. Mo. 1977).

- **The recipient’s research was of no practical application:** The court based its conclusion that the amounts received by Dr. Krupin were not payments for services, in part, on its conclusion that “Dr. Krupin’s research was, by his own statement, of no practical application. Instead, it served only to aid in the progress of science.” In the present matter, however, the non-NRSA fellows are providing valuable research services.⁷⁹
- **The recipient independently chose the topic of his research:** The court also based its conclusion on its observation that “Dr. Krupin chose the topic [of the research] himself.” As the discussions above and in the CCA demonstrate, however, in the present matter, Taxpayer did not give the non-NRSA fellows the ability to choose the topics of their research independently.⁸⁰

⁷⁸ Protest at 27.

⁷⁹ For example, as noted in Section III of this document, Taxpayer receives over \$ _____ million in research grants each year, _____ % of this revenue is derived from non-NRSA grants, and, under each of these grants, non-NRSA fellows provide substantial—and sometimes nearly all—all of the required research services.

⁸⁰ See *supra* Section III (citing documents that demonstrate that “[n]on-NRSA post-doctoral fellows do not have a large amount of freedom to determine their own research tasks.”

- **The recipient had the flexibility to explore other research topics:** Another factor that was critical to the court's conclusion in *Krupin* was that Dr. Krupin "freely deviated from his designated research into other areas when he was faced with delays in procuring equipment." In the present matter, by contrast, the terms of the non-NRSA fellows' appointment letters routinely specified that they would not be compensated for exploring other research topics. Similarly, Taxpayer was contractually bound by the very non-NRSA research grants under which these individuals were compensated to provide specific research services; for Taxpayer to provide such non-NRSA funds to fellows for other purposes would thus put Taxpayer in breach of its contracts.⁸¹
- **The recipient's services did not provide the grantor with any particular benefit:** The court also observed that, "The findings of Dr. Krupin's research provided no more specific benefit to the NIH than to any other medical institution or researcher having access to such published results. In fact, the court found that the benefits of Dr. Krupin's research accrued to the national academic community rather than to the grantor." In the present matter, by contrast, the non-NRSA fellows provided such specific benefits by providing the particular research services that their grants sought.⁸²
- **The recipient himself applied for the research grant:** In *Krupin*, Dr. Krupin himself applied for the research grant under which he was compensated.⁸³ In the present matter, however, the principal investigators, not the non-NRSA fellows, apply for the research grants.⁸⁴
- **The recipient did not submit progress reports, or review the recipient's research:** The payment recipient in *Krupin* "did not submit progress reports to NIH [the granting agency]." Further, the granting agency did not review his research. In the present matter, however, Taxpayer was required to provide the granting agencies with regular progress reports that detailed its progress towards satisfying the research services that the grants required.⁸⁵
- **The recipient was not supervised:** In *Krupin*, Dr. Krupin "received no direct supervision from Dr. Becker or from NIH." In the present matter, by contrast, the

⁸¹ See, e.g., CCA at 5 (summarizing evidence that each non-NRSA grant "funded a specific research project").

⁸² See *supra* Section III (citing documents that demonstrate that Taxpayer engaged the non-NRSA post-doctoral fellows for specific projects).

⁸³ The court noted to this end that, "In December 1971, Dr. Krupin applied for a Special Research Fellowship from the National Institutes of Health (hereinafter referred to as NIH), an agency of the United States Department of Health, Education and Welfare, to continue his research in ophthalmology."

⁸⁴ See, e.g., Protest at 10 (noting that "R01 proposals are written by principal investigators for specific research activities").

⁸⁵ See, e.g., CCA at 7 (summarizing the manners in which Taxpayer had to account for its progress to the granting agencies).

non-NRSA fellows were subject to substantial supervision.⁸⁶

B. *Bieberdorf v. Commissioner*, 60 T.C. 114 (1973):

- **The recipient did not provide his host institution with valuable services:** The court observed in *Bieberdorf* that, “Dr. Bieberdorf spent minimal time performing clinical services for the hospital.” That is, Dr. Bieberdorf’s activities did not benefit the host institution. By contrast, in the present matter, the non-NRSA fellows substantially benefitted Taxpayer by providing it with valuable, specific research services.⁸⁷
- **The services that the recipient provided were only incidental to his training:** In *Bieberdorf*, the court observed that the payment recipient’s “services were only incidental to his training.” In the present matter, however, the non-NRSA fellows’ training is only incidental to their services.⁸⁸
- **The recipient had the flexibility to explore other research topics:** In *Bieberdorf*, “Dr. Bieberdorf was free to perform research of his own choice.” In the present matter, however, Taxpayer only compensated fellows under non-NRSA research grants for providing the specific research services that were the subject of the research grants.⁸⁹
- **The recipient’s host institution did not particularly benefit from the recipient’s services:** The court also rested its holding in *Bieberdorf* on its determination that Dr. Bieberdorf’s research activities “tended to benefit the academic community as a whole.” Taxpayer in the present matter, however, particularly benefitted from the non-NRSA fellows’ research activities.⁹⁰

C. *Vaccaro v. Commissioner*, 58 T.C. 721, 729 (1972):

- **In both *Vaccaro* and the present case, the “form” of the research grants suggests that the payments were compensatory:** The court in *Vaccaro* determined that the “form” of the payments from the University to the payment recipient presented “strong circumstantial evidence that [the recipient] was a university employee.” The court observed that the University provided the recipient with full faculty privileges, treated the recipient as an employee for purposes of payroll and recordkeeping, and was required by the granting agency to designate all payments that the recipient received under the grant as salaries and wages. In the

⁸⁶ See, e.g., *id.* at 9 (summarizing the ways in which Taxpayer supervised non-NRSA fellows).

⁸⁷ See *supra* notes 60-65 and accompanying text.

⁸⁸ See, e.g., CCA at 16 (stating that, “Although non-NRSA fellows inevitably receive training as a result of performing research tasks that are new to them and working with an experienced supervisor, the clear quid pro quo for the payments is the research work.”).

⁸⁹ See, e.g., *supra* notes 47-50 and accompanying text.

⁹⁰ See, e.g., *supra* notes 60-65 and accompanying text

present case, the “form” of the payments from Taxpayer to the non-NRSA fellows presents similarly strong circumstantial evidence that the payments were compensatory. As discussed earlier, these grants required Taxpayer to treat these payments as compensation for services and the Taxpayer treated the non-NRSA fellows as employees.⁹¹

- **Unlike in *Vaccaro*, however, the “substance” of Taxpayer’s fellows’ duties indicate that their payments were compensatory:** Although *Vaccaro* stated that the “form” of the payments at issue suggested that the payments were compensatory, the court determined that the “substance” of the payments—that is, the actual actions and expectations of the payment recipient—indicated that the payments were not, in fact, compensatory. The substantive facts and circumstances upon which the court in *Vaccaro* relied to make this conclusion are, however, readily distinguishable from the facts and circumstances of the present case:
 - **The host institution did not require the recipient to perform specific services:** The court in *Vaccaro* based its conclusion that the amounts at issue were not payments for services largely on its observation that the payment recipient “was not required to perform any specific services for the university or the center and did not participate in any of the center’s research projects, but engaged in research designed to develop his own professional skills.” In the present matter, however, Taxpayer did require the non-NRSA fellows to provide specific, enumerated services.⁹²
 - **There was no expectation that the recipients would provide benefit to the host institution:** In *Vaccaro*, the court concluded that “the facts clearly show that no significant benefits or services were expected from petitioner by the university as a result of his work there. The letters between petitioner and Pellegrin prior to and after his appointment make it clear that both parties believed the position to be a postdoctoral fellowship and not employment. Nowhere in the correspondence is there any mention of obligations or duties to be required of petitioner in exchange for the \$10,500 stipend.” In the present matter, however, Taxpayer expected that the recipients would provide

⁹¹ In numerous other cases, in the course of determining whether payments are compensatory under § 117, courts have considered the “form” of payments. See, e.g., *Woodfin v. Commissioner*, T.C. Memo. 1972-49 (T.C. 1972) (emphasizing that the form of the payments received by a research associate was “denominated . . . as wages and salaries” in the University’s records, and ultimately holding that the amounts “were compensation for services rendered as a research associate in assisting the University to complete the research project that the NSF [the granting agency] had financed”); *Kao v. Commissioner*, T.C. Memo 1977-288 (T.C. 1977) (observing that the form of the payments received by a Penn State University research associate under an NIH research grant were relevant in that “salaries are permissible under NIH research grants only if the recipient renders personal services to the approved research projects,” and that the “NIH does not award stipends on research grants”; the court ultimately held that the “primary purpose of [the research associate’s] salary was to enable Penn State to obtain his assistance in meeting its research commitment to NIH”).

⁹² See, e.g., *supra* notes 60-65 and accompanying text.

it with benefit; it is for this reason that Taxpayer hired non-NRSA fellows by reference to their aptitudes to provide specific research services. Further, as discussed above, these non-NRSA fellows did, indeed, provide Taxpayer with substantial benefits.⁹³

- **The recipient conducted his research autonomously:** Also crucial to Vaccaro's conclusion that the amount at issue was not a payment for services was the fact that the recipient was:

expected to work autonomously, doing research and study to improve his own individual capacity, but a look at what he actually did during the school year will disclose that he, in fact, was on his own. Petitioner's efforts were directed entirely to coursework, as a student, reading, and some writing, the products of which were published in professional magazines. He also edited a book and participated in a symposium on 'Problems Related to the Development of Theory in Administration.' These activities impress us as being entirely, or at the very least primarily, for the benefit of petitioner. There was little or no return to the CASEA program other than strictly incidental benefits. Petitioner spent very little time with the permanent research staff and had no close contact with the formal research projects of CASEA. Thus, we are unable to ascertain any significant benefits to the university, past, present, or future, which actually resulted from petitioner's activities.

In the present matter, however, Taxpayer subjected the non-NRSA fellows to substantial supervision and compensated them with funds from non-NRSA research grants only for engaging in services that were the subjects of the grants.⁹⁴

VI. Non-NRSA fellows receive compensation for employment services.

Throughout its Protest, Taxpayer repeatedly argues that non-NRSA fellows do not receive compensation for employment services.⁹⁵ It bases this argument on its assertions that the research activities of non-NRSA fellows "are the same as the research activities of the NRSA fellows [who are not employees] at the ."⁹⁶ As discussed above, however, the research activities of NRSA and non-NRSA fellows are distinct in several significant ways.⁹⁷ In particular, fellows receive the proceeds of non-NRSA research grants in exchange for the provision of particular, defined, substantive research services.

⁹³ *Id.*

⁹⁴ *See, e.g., supra* note 59 and accompanying text.

⁹⁵ *See, e.g.,* Protest at 3, 9, 16, 17, 25, 26, 30, 31, 35.

⁹⁶ *Id.* at 26.

⁹⁷ *See supra* Parts III & IV.

Taxpayer further supports this argument by asserting that the duties of non-NRSA fellows are distinguishable from those of laboratory technicians (who are employees).⁹⁸ Taxpayer, to this end, states that laboratory technicians “are considered employees” because they typically work “40 hours per week, under a set schedule, with defined responsibilities,” and are “told what tasks need to be completed for a specific day or week and in what manner the tasks are to be completed.”⁹⁹ The Service’s review of the documents provided by Taxpayer indicates that these very same or similar limitations apply to non-NRSA fellows, too. As discussed both in the CCA and above, Taxpayer engages non-NRSA fellows to provide specific research services,¹⁰⁰ does not allow them a large amount of freedom to determine their own research tasks,¹⁰¹ and has authority over when, where, and how the non-NRSA fellows are to conduct their research.¹⁰² It is therefore not the case that payments to laboratory technicians are as distinguishable from those to non-NRSA fellows as Taxpayer asserts.

Taxpayer’s assertions that non-NRSA fellows do not receive compensation for employment services is also at odds with the documentation and certifications, discussed above, that Taxpayer is required to provide under OMB Circular A-21 with respect to payments it makes to non-NRSA fellows.

So too are these assertions at odds with Taxpayer’s employment policies, also discussed above, which objectively distinguish those fellows whom it classifies as “employee fellows,” including non-NRSA fellows, from those whom it classifies as “non-employee fellows,” such as NRSA fellows. These policies authorize Taxpayer to provide non-NRSA (but not NRSA) fellows with remuneration packages that are consistent with the existence of an employer-employee relationship.

VII. Refund requirements under OMB Circular A-21.

Pursuant to OMB Circular A-21 taxes which the institution is required to pay and which the institution pays or accrues in accordance with generally accepted accounting principles are allowable. However, any refund of taxes, interest, or penalties, and any payment to the institution of interest thereon, attributable to taxes, interest, or penalties allowed as sponsored agreement costs, must be credited or paid to the federal government in the manner directed by the federal government. Therefore, if Taxpayer is determined to have overpaid FICA taxes in this matter, the IRS should coordinate with appropriate federal agencies regarding the recoupment of said amounts.

VIII. Conclusion

⁹⁸ Protest at 17.

⁹⁹ *Id.*

¹⁰⁰ See *supra* Part IV

¹⁰¹ See *supra* Part IV

¹⁰² CCA at 17.

For the reasons discussed above the Service reaffirms the conclusion set forth in the CCA.

Please call Syd Gernstein at (202) 622-6040 if you have any further questions.